

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Hayden Analyst: Kimberly Pantoja Bill Number: SB 1626
Related Bills: See Legislative History Telephone: 845-4786 Introduced Date: 02/22/2000
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Internet Access Refundable Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a one-time refundable credit in an amount equal to 80% of the cost paid or incurred, not to exceed \$500, for obtaining a personal computer, printer, and access to the Internet by taxpayers qualifying for the federal Earned Income Credit (EIC).

This analysis will not address the bill's provisions regarding the Public Utilities Commission, as they do not impact the department's programs and operations.

EFFECTIVE DATE

This bill would be effective January 1, 2001. By its terms the tax credit would apply to taxable years beginning on or after January 1, 2000, and before January 1, 2005.

LEGISLATIVE HISTORY

SB 1817 (2000) proposes a credit of an unspecified amount to any taxpayer who provides an Internet connection and an Internet access device without charge to a low-income household. AB 2163 (2000) proposes credits for taxpayers who provide low-income households a computer or Internet access.

SPECIFIC FINDINGS

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and must exceed 2% of adjusted gross income (AGI) to be deducted. Individuals generally cannot deduct items such as personal computers or Internet access, unless the equipment is used in a trade or business.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Alan Hunter for GHG

4/3/00

Existing federal law allows eligible individuals a refundable EIC. Income amounts phase-out based on the number of qualifying children. The 1999 federal EIC phase-out amounts are as follows:

Eligible Individual with	Completely Phased-out @
1 qualifying child	\$26,928
2 or more qualifying children	\$30,580
no qualifying children	\$10,200

Under provisions of federal law (Title IV of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193)), certain aliens are ineligible for federal, state and local public benefits, including the EIC. The IRS delays all returns claiming the federal EIC that do not pass an automated Social Security number verification process. By its terms, this federal law applies to states.

Under **state law**, individuals who make less income than the filing thresholds are not required to file an income tax return since the standard deduction and personal exemption credit would eliminate any tax liability. For 1999, these thresholds are \$10,899 in gross income or \$8,719 in adjusted gross income (AGI) for single taxpayers and \$21,798 in gross income or \$17,438 in AGI for married filing joint taxpayers. These thresholds are indexed annually.

Current federal and state laws do not allow a credit for providing Internet connections and Internet access devices.

This bill would allow a one-time refundable credit in an amount equal to 80% of the cost paid or incurred, not to exceed \$500, for obtaining a personal computer, printer, and access to the Internet by taxpayers qualifying for the federal EIC.

This bill specifies any credit in excess of the tax liability shall be credited against other amounts due, and the balance shall be refunded to the taxpayer.

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

Since **this bill** does not specify otherwise, the existing state law regarding the division of credits among two or more taxpayers, a husband and wife, and partners, would apply.

Policy Considerations

Historically, refundable credits (such as the state renter's credit, the federal Earned Income Credit and the federal credit for gasoline used for farming) have had significant problems with invalid and fraudulent returns.

This bill does not restrict the credit to taxpayers who obtain computers or printers for use within California or to taxpayers who obtain access to the Internet from within California.

Currently the department is moving toward paperless, electronically filed (E-file) returns. This bill would support the direction of the department by allowing more taxpayers to access the Internet.

Implementation Considerations

As a refundable credit allowed to taxpayers qualifying for the federal EIC, this credit may be interpreted to be a state public benefit under federal law. As a public benefit, the proposed credit may fall under the federal provisions making certain aliens ineligible for state public benefits. To establish eligibility, the claimant must declare himself/herself to be a citizen of the United States or an eligible alien. Verification of eligibility significantly complicates the implementation of refundable tax credits.

The proposed credit would be based on the taxpayer qualifying for the federal EIC, which is calculated using modified adjusted gross income figures (non-taxable and taxable earned income). The FTB does not have immediate access to the federal modified adjusted gross income figures and would have difficulty verifying the taxpayer's eligibility at the time of filing.

The proposed credit under this bill would be claimed by low-income taxpayers. Low-income taxpayers generally file their tax returns on forms 540A, 540EZ or 540-2EZ. To minimize the complexity of these returns, the only credit currently allowed on these forms is the nonrefundable renters' credit. Adding lines to these forms would increase their complexity and could have a moderate to significant impact on the department's operations.

The bill does not specify the length of time during the year that the Internet service must be obtained to qualify for the credit. Therefore, it appears if service were obtained for any period during the year, the taxpayer would qualify for the credit. If the author's intent is to guarantee access to the Internet, a requirement that the credit only be allowed if access continues throughout the year or for some specified period may be appropriate. Also, such a requirement would eliminate concerns that a computer may be purchased, the credit claimed, and the computer immediately sold.

It is unclear whether such devices as televisions with Web-TV and palm-pilots would qualify for the credit. Also, a variety of peripherals, such as cables, surge protectors, and software, are frequently purchased with a computer. It is also unclear whether services that accommodate access to the Internet such as telephone service would be considered a cost incurred in obtaining access to the Internet. A precise definition for "costs paid or incurred for obtaining a personal computer, printer, and access to the Internet" is needed.

It also is unclear if the "one-time refundable tax credit" limitation applies per taxpayer or per household. For example, if a husband and wife file separate tax returns, it is unclear whether both could claim the credit if they each obtained the required equipment. Clarification is needed to avoid disputes between the department and taxpayers and ease the administration of the credit.

Personal computers and Internet service are becoming easier to obtain through manufacturer rebate programs. Taxpayers may be eligible for various rebates ranging up to \$700, thus lowering the purchase price of the equipment required for this credit. The department would have no way of verifying that the taxpayer subtracted the amount of the rebate when determining the cost upon which the credit is calculated.

It is unclear whether a personal computer, printer, and access to the Internet must all be obtained within a single taxable year and if not, in which taxable year the taxpayer should claim the credit. A taxpayer might prefer to claim the one-time credit for the taxable year with the greatest expenditure. However, Internet access might be obtained in a year where expenses eligible for the credit would be less than eligible expenses in prior years.

Most taxpayers that qualify for the federal EIC probably have little or no federal or state tax liability, and therefore do not have a California filing requirement. They would be filing tax returns to claim the proposed Internet Access Credit. The additional filing of returns may significantly impact the department's programs and costs.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved, but could be significant.

Tax Revenue Estimate

Based on data and assumptions discussed below, revenue losses from this bill are estimated to be as follows:

Estimated Revenue Impact of SB 1626 As Introduced February 22, 2000 Taxable Years Beginning After 12/31/99 and Enactment After 6/30/2000			
Fiscal Years	2000-01	2001-02	2002-03
Revenue Impact (Rounded)	-\$16	-\$18	-\$18

It is assumed that all three components must be acquired during the year to qualify for this credit (i.e. computer, printer, and access to the Internet).

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

Revenue losses from this refundable credit would depend on the total amount of purchases by qualified households during the year.

According to Internal Revenue Service data ("Statistics of Income Bulletin"), nearly 2.5 million California households claimed the federal earned income tax credit for tax year 1997.

Reportedly, 40% of all U.S. households have computers, compared to 8% of families with less than \$10,000 of annual income. The federal EIC is available to households in lower income groups (generally less than \$30,000). The households estimated to purchase computers with the other required components was 5% for those with less than \$20,000 of AGI and 8% for households up to \$30,000 of AGI.

The following steps were used to project revenue impacts:

- From the total number of California households claiming the federal EIC in 1997 (nearly 2.5 million), there were nearly 2 million claims from the income group below \$20,000 and more than 400,000 claims from households with income between \$20,000 to \$30,000 per year. These numbers were expanded by 2% annually to project the number of households in year 2000 and thereafter.
- It was assumed that only 5% of households with less than \$20,000 of AGI and claiming the federal EIC already own a computer with the other required components and 8% for the higher income group (106,000 and 35,000 owners respectively).
- Annual purchases by qualifying low-income taxpayers, before considering an incentive effect, were estimated to be 20% (reflects an average holding period for existing computers of five years), which results in around 28,000 qualified purchases per year.
- It was assumed that this proposed refundable credit (up to \$500) would create an incentive effect of 25% of additional purchases for both income groups.

Based on these assumptions, the number of qualified credit claims would be on the order of 35,000 for year 2001. The number of credit claims is projected to grow annually corresponding to the California population growth (2% per year) prior to incentive effects.

If the maximum credit of \$500 were applied, annual revenue losses would be on the order of \$18 million per year. With an assumed enactment date after June 30, 2000, the first year's incentive effect (year 2000) was cut in half.

It should be noted that if this bill's intention is to provide this refundable credit for purchase of any one of the specified components, revenue losses would be substantially larger.

BOARD POSITION

Pending.